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IN THE

Supreme Court of the United States

LEE M. TILL, et ux.,

Petitioners,

v.

SCS CREDIT CORPORATION,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF CHAPTER THIRTEEN TRUSTEES SUPPORTING PETITIONERS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*

The National Association of Chapter Thirteen Trustees ("NACTT") is a non-profit, educational organization composed of consumer bankruptcy professionals.[1] Its membership represents a broad spectrum of participants in the consumer bankruptcy process including debtors' attorneys, creditors' representatives, and Standing Chapter 13 trustees. The NACTT's voting membership is composed of private trustees appointed by the U.S. Department of Justice, Executive Office of the U.S. Trustee (see 28 U.S.C. § 586) and in the federal judicial districts of North Carolina and Alabama by the judiciary. Approximately 98% of the Standing Chapter 13 trustees in the United States are voting members of the NACTT. Andrea Celli, a Standing Chapter 13 Trustee for the Northern District of New York and current President of the NACTT, and the NACTT's Board of Directors, ratified by the NACTT's voting membership, have directly authorized Henry E. Hildebrand, III, Standing Chapter 13 Trustee in the Middle District of Tennessee, to prepare and submit this *amicus curiae* brief on the NACTT's behalf.

Historically, Congress and federal courts have observed that the more efficient and effective Chapter 13 programs have been conducted by Standing Chapter 13 trustees who exercise a broad range of responsibilities in both the design and effectuation of Chapter 13 plans. *Matter of*

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1. The parties have consented to the filing of this brief. Their letters of consent are being filed herewith. This brief has been authored in its entirety by undersigned counsel for the *amicus curiae*. No person or entity, other than the named *amicus* and its counsel, made any monetary contribution to the preparation and submission of this brief.

Maddox, 15 F.3d 1347, 1355 (5th Cir. 1994). A Chapter 13 trustee has a statutory responsibility to participate in the confirmation and administration of every Chapter 13 plan. *See* 11 U.S.C. § 1302. The trustee represents the interests of all creditors by exercising various powers to ensure that the collection of the debtor's disposable income and disbursement of that money to creditors pursuant to the plan occurs according to the dictates of Congress as set forth in the Bankruptcy Code. *Maddox*, 15 F.3d at 1355. A Chapter 13 trustee, like bankruptcy trustees in general, is charged with the representation of general creditors and is empowered to assert claims, avoid preferences, collect property of the estate, and examine and object to creditors' claims in furtherance of the congressional goal of equitably distributing property of the estate to the creditors. *Id.* at 1355; *See In re Gustav Schaeter Company*, 103 F.2d 237 (6th Cir. 1939). The goals of bankruptcy include maximizing the greatest economic benefit to the greatest number of participants in the bankruptcy process.[2] A trustee, as the principal administrator of a Chapter 13 case, is charged with the responsibility of maximizing the possible return for distribution to creditors. *See In re Kessler*, 186 F. 127 (2nd Cir. 1911).

Bankruptcy is thus a collective legal process, where the differing constituencies are best served by a fair and equitable modification of various rights for the common good.

2. Bankruptcy and the policies that shape it have a number of constituencies invested in the outcome. One commentator has identified them as voluntary creditors, owners (debtors or shareholders), tort creditors, employees and the general community. Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. Ill. L. Rev. 1.

Accordingly, the automatic stay[3] precludes immediate repossession of collateral by secured lenders to preserve income producing potential for the entire estate and the trustee's strong-arm powers[4] and other avoidance powers prevent unfair pre-petition favoritism amongst creditors. In the same way, a restructuring of the rights between a debtor and a secured creditor under Chapter 13 of the Bankruptcy Code should be accomplished with the goal of preserving the property interests of that creditor in its collateral while still giving the reorganizing debtor the opportunity to repay *all* creditors as much as possible.[5] To the extent that any creditor, secured, unsecured, or otherwise, receives a distribution that is greater than the fair distribution required by law, such cost is born, not by the debtor, but by the other creditors and constituencies and such makes financial rehabilitation more difficult. Chapter 13 trustees seek to implement fairness to all creditors and avoid inequitable distributions of estate property.

In consideration of the foregoing, Standing Chapter 13 trustees are in a unique position to objectively argue the issues raised in this review. Adoption of the Seventh Circuit's ruling in *In re Till*, 301 F.3d 583 (7th Cir 2002) that application of a creditor's contract rate of interest to its allowed secured

3. 11 U.S.C. § 362.

4. 11 U.S.C. §§ 544, 547, 549.

5. *See, e.g.*, Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 Columb. L. Rev. 717 (1991) ["In responding to financial distress, bankruptcy law sometimes should and must alter rights recognized under substantive non-bankruptcy law. This is not a forbidden act, as the economic account suggests; it is an essential and inevitable part of a full response to the problem of financial distress."]

claim, absent persuasive evidence otherwise, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan would impair equitable distributions to all creditors in most Chapter 13 cases. The *amicus* asserts that the language of the Bankruptcy Code, its underlying legislative history, and decades of bankruptcy policy support the conclusion, contrary to the Seventh Circuit's ruling, that the contract interest rate is not the source of the present value factor and bears no part in determining the "value, as of the effective date of the plan" of an allowed secured claim under 11 U.S.C. § 1325(a)(5)(B)(ii). The NACTT believes that the Seventh Circuit's interpretation of that statute will result in the formulation of Chapter 13 plans that artificially favor a particular creditor's interests at others' expense.

SUMMARY OF THE ARGUMENT

In *In re Till*, 301 F.3d 583 (7th Cir 2002), the Seventh Circuit Court of Appeals ruled that a creditor's contract rate of interest, absent persuasive evidence otherwise, together with the replacement value of the creditor's collateral, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). The plain meaning of § 1325(a)(5)(B)(ii) does not require the debtor to pay the contract interest rate. Principles of statutory construction, legislative history and bankruptcy policy, supported by correctly decided case law, show that § 1325(a)(5)(B)(ii) requires the debtor to pay the present value of the allowed secured claim. "Present value" and "interest" are two separate and distinct economic concepts. Present value is based upon the common sense notion that a dollar paid to you one year

from now is less valuable to you than the dollar paid to you today. Interest, on the other hand, has been said to represent the price of the use of money and can include the expected rate of inflation, the riskiness of the borrower, the liquidity of the borrowing investment, and the time to maturity.

In *Till*, the Seventh Circuit has adopted a "coerced loan" approach to determine present value which focuses on the secured creditor's specific contract rate. The "coerced loan" approach is flawed. It is not authorized by statute or legislative history and it confuses "present value" with "interest." It undermines basic policies underlying the Bankruptcy Code. The coerced loan approach allows secured creditors to recover profit and overhead, items which secured creditors are not entitled to recover under § 1325(a)(5)(B)(ii) and which in some cases is higher than in others due to the creditor's own risk taking and inefficient business practices. This approach is creditor specific, meaning that similarly situated secured creditors are not treated equally. It can produce a result that allows a secured creditor to receive more than the present value of its allowed secured claim at the expense of the other creditors in the case which results in unfair discrimination among creditors. Finally, it is not efficient or practical in the context of Chapter 13 case administration.

This Court should instead adopt a "formula approach" to determine present value such as adopted by the Second Circuit in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997). In *Valenti*, the Second Circuit concluded that the present value component of an allowed secured claim should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium of one to three percentage points to reflect the creditor's risk in receiving

deferred payments. The Treasury Rate is the most appropriate rate to use in determining "value, as of the effective date of the plan," because it includes some components of interest that comprise a discount rate, or present value, such as inflation and liquidity, but does not include the interest components to which a creditor is not entitled such as profit, default, or risk premiums. Utilizing the Treasury Rate fulfills the statutory requirements and advances the policies of the Bankruptcy Code by paying a secured creditor that to which it is entitled and promoting fairness among creditors. Unlike a creditor specific rate, this rate is simple and efficient to compute.

In the event that this Court rejects a formula approach utilizing the Treasury Rate but instead decides to utilize a coerced loan approach, this Court should consider the Sixth Circuit's ruling in *In re Kidd*, 315 F.3d 671 (6th Cir. 2003) which held that the interest rate a secured creditor should receive under § 1325(a)(5)(B)(ii) is "the current conventional market rate for similar loans in the region, and not necessarily the contract rate." Although the *Kidd* court's coerced loan approach is subject to many of the same criticisms as the coerced loan approach of other courts, the Sixth Circuit has at least introduced some sense of equality between similarly situated creditors by rejecting a "market rate" dictated by a particular creditor.

ARGUMENT

I. STATUTORY CONSTRUCTION OF THE BANKRUPTCY CODE ARGUES AGAINST USING A CREDITOR'S CONTRACT RATE OF INTEREST TO CALCULATE THE PRESENT VALUE OF AN ALLOWED SECURED CLAIM UNDER 11 U.S.C. § 1325(a)(5)(B)(ii).

A. The Plain Language of 11 U.S.C. § 1325(a)(5)(B)(ii) Does Not Require the Payment of a Creditor's Contract Rate of Interest.

A Chapter 13 debtor may propose a plan that provides for an allowed secured claim in one of three ways. First, a secured creditor may accept the plan's proposed treatment of the allowed secured claim thereby relieving the debtor from obtaining court approval of the treatment of that creditor's claim. 11 U.S.C. § 1325(a)(5)(A). Second, a Chapter 13 plan may propose to surrender collateral back to a secured creditor, thus eliminating the secured claim. 11 U.S.C. § 1325(a)(5)(C). Third, the statute permits the debtor to propose, and obtain confirmation of, a plan over the creditor's objection, as long as the plan meets the requirements of 11 U.S.C. § 1325(a)(5)(B)(ii). This third method of providing for a creditor's allowed secured claim is the subject of this appeal. In *Till*, the Seventh Circuit ruled that absent persuasive evidence otherwise, the secured creditor's contract rate of interest plus replacement value of the collateral is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). The NACTT submits, however, that the plain language of the statute, when

read with other sections and considered in light of the legislative history of the Bankruptcy Code, does not require the payment of a creditor's contract rate of interest on an allowed secured claim.

To ascertain the meaning of this statute, one should begin its analysis by examining the plain language of the sentences that comprise § 1325(a)(5)(B)(ii) of the Bankruptcy Code. *Patterson v. Schumate*, 504 U.S. 753, 757 (1992). The statute provides, in pertinent part:

> . . . [T]he court shall confirm a plan if . . .
>
> (5) with respect to each allowed secured claim provided for by the plan . . .
>
> (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and
>
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; . . .

This Court ordinarily resists reading words or elements into a statute that do not appear on its face. *Bates v. U.S.*, 522 U.S. 23, 29 (1997). The provisions of the Bankruptcy Code, including § 1325(a)(5)(B)(ii), must be read *in pari materia* to ascertain their meaning. *See, e.g., United States Savings Ass'n v. Timbers of Inwood Forest*, 484 U.S. 365, 370-72 (1988); *Matter of Maddox*, 15 F.3d 1347, 1354 (5th Cir. 1994). Section 1325(a)(5)(B)(ii) does not contain the term "interest"

and this Court should not read that term into the statute. By contrast, Congress expressly authorized a fully secured creditor to collect "interest" as a part of its allowed secured claim under § 506 of the Bankruptcy Code which provides:

> To the extent an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, *interest on such claim*, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

11 U.S.C. § 506(b) (emphasis added). Again, Congress utilized the term "interest" in § 726(a) of the Bankruptcy Code, establishing the priority for distribution of property of the estate in a Chapter 7 case. Section 726(a) provides, "[F]ifth, in payment of *interest* at the legal rate from the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection." 11 U.S.C. § 726(a)(5) (emphasis added).

This Court has previously ruled that where Congress includes particular language in one section of a statute but omits it in another section of the same act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion. *Bates*, 522 U.S. at 29-30 (citing *Russell v. United States*, 464 U.S. 16, 23 (1983)). Accordingly, where Congress included the term "interest" in §§ 506 & 726 but not in § 1325(a)(5)(B)(ii), this Court must presume that Congress did so purposefully. Based upon the foregoing, the NACTT submits that the plain language of § 1325(a)(5)(B)(ii), while requiring the payment

of the present value of a secured claim, does not require the payment of the contract rate of interest on a creditor's allowed secured claim.

B. The Legislative History Demonstrates that Congress Did Not Intend 11 U.S.C. § 1325(a)(5)(B)(ii) to Require the Payment of a Creditor's Contract Rate of Interest.

To the degree that the plain language of § 1325(a)(5)(B)(ii); *i.e.* "the value, as of the effective date of the plan," when read together with other sections of the Bankruptcy Code, does not explicitly resolve the matter, one should look to the legislative history of the Bankruptcy Code to give meaning to the statute. *See Matter of Maddox*, 15 F.3d at 1354. This legislative history further supports the position of the NACTT and the Appellant. Describing the effect of what was initially to be § 1129(a) under Chapter 11 of the Bankruptcy Code (another reorganization chapter), the House Committee Report states that the use of the concept of value "as of the effective date of the plan" requires analysis independent of simply searching for the contract interest rate. The original bill precluded confirmation of a Chapter 11 plan if distributions to a secured creditor exceeded the claim's value. The Report states:

> [1129(a)] contemplates a present value analysis that will discount value to be received in the future; of course, if the interest rate paid is equivalent to the discount rate used, the present value and the face future value will be identical. On the other hand, if no interest is proposed to be paid, the present value will be less than the face future value. For example, consider an allowed secured claim of $1,000 in a class by itself.

> One plan could propose to pay $1,000 on account of this claim as of the effective date of the plan. Another plan could propose to give a note with a $1,000 face amount due five years after the effective date of the plan on account of this claim. A third plan could propose to give a note in a face amount of $1,000 due five years from the effective date of the plan plus 6% annual interest commencing on the effective date of the plan on account of this claim. The first plan clearly meets the requirements of subparagraph (a) because the amount received on account of such claim has an equivalent present value as of the effective date of the plan equal to the allowed amount of such claim. The second plan also meets the requirements of subparagraph (a) because the present value of the five years note as of the effective date of the plan will never exceed the allowed amount of the secured claim; the higher the discount rate, the less present value the note will have. Whether the third plan complies with subparagraph (a) depends on whether the discount rate is less than 6%.

HR 95-598, September 8, 1997 95th Congress 1st Session, 350 (1977).

"Present value" is a concept "based upon the common sense notion that a dollar paid to you one year from now is less valuable to you than the dollar paid to you today." Frederick Mishkin, *The Economics of Money, Banking and Financial Markets* 69 (Addison Wesley 2001); *See* Paul A.

Samuelson, *Economics* 47-48 (McGraw-Hill Book Company, Inc. 1948). As the bankruptcy court in *In re Wilkinson*, 33 B.R. 933 (Bankr. S.D. N.Y. 1983) noted:

> "Present value" or the "time value of money" is not a legal concept, but rather it is a term of art in the financial community. It simply means that a dollar received today is worth more than a dollar to be received in the future. To compensate the creditor for not receiving its money today, the debtor is charged an additional amount of money. The charge is based on a rate of interest called "discount rate." The discount rate is used to calculate how much the creditor should be paid so it will have the same amount of money in the future as it would have had if it did not have to wait to be paid.

In re Wilkinson, 33 B.R. at 936, n.2. Concerning the "discount rate," it has been noted:

> [F]rom an economic perspective, the discount rate represents compensation for the time value of money. In effect, the discount rate is the price or exchange rate that is paid to compensate a lender who foregoes current spending or investment opportunities to make a loan. This compensation includes three components: (1) a real rate (the basic rate established by the demand for borrowing and the supply of capital to compensate for the mere passage of time, without taking into account expected inflation or risk); (2) an expected inflation rate (to compensate for the

> expected loss in purchasing power); and (3) a risk premium (to compensate for the uncertainty regarding the actual return).

Dean Pawlowic, *Entitlement to Interest Under the Bankruptcy Code*, 12 Bankr. Dev. J. 149, 174 (1995).

"Interest," on the other hand, has been said to represent "the price of the use of money." Samuelson, 303. Interest can include the expected rate of inflation, the riskiness of the borrower, the liquidity of the borrowing investment, and the time to maturity. Stanley G. Eakins, *Finance: Investments, Institutions & Management* 77 (Addison Wesley 1999). Interest is composed of profit, administrative costs, risks, industry transaction costs, costs of collection, and other elements. It has been observed that interest is composed of "(1) pure interest, (2) an inflation premium, (3) a default premium, (4) a liquidity or market ability premium, and (5) a maturity or risk premium." *In re Smith*, 178 B.R. 946, 954 (Bankr. D.Vt. 1995); *See also* J. Fred Weston and Eugene Brigham, *Essentials of Managerial Finance* 10th Edition (1990). These contractual rights are subject to modification under all reorganization chapters of the Bankruptcy Code, including Chapter 13. See §§ 1123(b)(1), 1222(b)(2) & 1322(b)(2).

Based upon statutory construction principles and the legislative history of the Bankruptcy Code, Congress clearly did not intend to require the payment of "interest" or "contract interest" on allowed secured claims under a Chapter 13 plan. Congress instead required that the plan provide to pay the present value of the claim. By distinguishing between "present value" and "interest," Congress recognized that the two concepts are different and that "interest" includes various

components that are not included in "present value" or "discount factor." Congress understood and used the term "interest"in sections of the Bankruptcy Code where it decided interest was required to be paid as in §§ 506(b) and 726(a)(5). Congress, however, did not include the requirement that "interest" be paid on allowed secured claims pursuant to § 1325(a)(5)(B)(ii). Congress simply required the secured claim be paid its present value.

C. The Seventh Circuit's Construction of 11 U.S.C. § 1325(a)(5)(B)(ii) Conflicts With Other Statutory Provisions of Chapter 13 Title 11 U.S.C. and Major Policy Considerations Underlying the Bankruptcy Code.

Construing § 1325(a)(5)(B)(ii)'s "value, as of the effective date of the plan" to mean a creditor's contract interest rate instead of "present value," the Seventh Circuit in *Till* creates a conflict between that statute and other provisions of the Bankruptcy Code equally applicable to Chapter 13 cases. For example, a Chapter 13 plan that allows a creditor to receive "interest" on its allowed secured claim where the interest rate exceeds "present value" violates the basic policy of bankruptcy law that "equity is equality" and that creditors with similar claims should be treated similarly. As observed by the Sixth Circuit Court of Appeals in *In re Kidd*, "to permit a secured creditor to receive interest on his claim in an amount greater than the conventional market rates would allow the creditor to actually receive more than the allowed amount of his secured claim." *In re Kidd*, 315 F.3d 671, 677 (6th Cir. 2003). In a Chapter 13 case, if a secured creditor receives a greater distribution towards its allowed secured claim, then it is actually receiving a distribution on account of its allowed unsecured deficiency

claim. In this situation, the creditor's unsecured claim (the deficiency remaining after application of 11 U.S.C. § 506) is being paid amounts in addition to the dividend to all general unsecured creditors resulting in unfair discrimination violating § 1322(b)(1). Also, as will be shown below, the application of *Till* to a typical Chapter 13 case creates creditor specific interest rates, as opposed to present value, resulting in disparate treatment of secured creditors within the same class further violating the basic bankruptcy policy of treating similarly situated creditors equally.

II. THE "FORMULA" APPROACH IS THE BEST METHOD FOR DETERMINING PRESENT VALUE UNDER 11 U.S.C. § 1325(a)(5)(B)(ii).

A. Confusing Interest with Present Value: The Origins of the Coerced Loan Approach.

It is true that some federal courts, like economists, confronted with the need to determine if a plan has met its obligation to pay the present value of secured claims have resorted to using the term "interest" as convenient shorthand for "present value." As noted above, however, interest in a contract is not the same as present value. This process of confusing "interest" with "present value" has apparently been traced to a leading treatise: *Collier on Bankruptcy* in a comment at 5 *Collier on Bankruptcy*, ¶ 1129-03, pp. 129-99, 15th ed. (1994). *See In re Computer Optics, Inc.*, 126 B.R. 664,671 (Bankr. D. N.H., 1991); *In re Smith*, 178 B.R. 946, 951 (Bankr. D.Vt. 1995)(modif'd, on other grounds,

In re Valenti, 105 F.3d 55 (2nd Cir. 1997)). At least two bankruptcy courts have stated:

> Without citing any case or other authority that existed at the time, the Collier treatise in that comment took a quantum leap from the present value concept in terms of the time value of money into a totally different concept of a loan transaction involving fact specific risk analysis.

Computer Optics, 126 B.R. at 671; *Smith*, 178 B.R. at 951 (citing *Computer Optics*). "Simply put, *Collier* confused loans and claims." *Id*. "As a result, judges have been functioning as commercial loan officers, economists, and financial managers in their opinions, and not as the overseers of the reorganization process." *Smith*, 178 B.R. at 951.

Colliding apples with oranges, in their attempts to create an interest rate that satisfies the present value requirement of § 1325(a)(5)(B)(ii), the courts have engaged in "a grueling exercise in self-impalement on concepts taken out of context. It has been observed that the attempt to award interest equivalent to the market rate for similar loans is doomed to produce chaos and confusion . . . because it starts with legal concepts that do not apply." *In re Smith*, 178 B.R. at 951.[6] The attempt has spawned a myriad of mutually exclusive approaches producing rates that could never be found in the market such as the "coerced loan" theory — that a secured

6. Judge Conrad's decision in *In re Smith* was subsequently modified as a result of the Second Circuit's decision in *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997) but the reasoning of Judge Conrad's opinion and its sound footing on statutory construction are well founded.

claim is to be treated as a new, albeit involuntary, loan and "present value" has transformed into "contract interest." *Id*. But, as has been noted, a "claim," under the Bankruptcy Code, is a right to payment and a "loan" under applicable non-bankruptcy law, is a contractual obligation which often includes the requirement to pay interest. *Smith*, 178 B.R. 951. "The obligation to pay interest on a claim, by contrast, is statutory, not contractual, and the amount of interest should be determined by reference to the appropriate statute, not the contract or market." *Id*.

The Courts of Appeals for the Third, Fourth and Fifth Circuits have extended the "current market rate" approach to provide that the rate of interest that a particular secured creditor would charge for a new loan similar in character, amount, and duration would be applicable in a Chapter 13 case. *General Motors Acceptance Corporation v. Jones* (*In re Jones*), 999 F.2d 63 (3rd Cir. 1993); *United Carolina Bank v. Hall*, 993 F.2d 1126 (4th Cir. 1993); *Matter of Smithwick*, 121 F.3d 211 (5th Cir. 1997). As noted by the Third Circuit in *Jones*, the application of this creditor's contract rate seeks to put the secured creditor in an economic position equivalent to one it would have occupied had it received its allowed secured claim amount immediately. *Jones*, 999 F.3d at 67. The "coerced loan theory" is, in fact, a "market rate" that is not based on any "market" but is rather based solely upon what a particular creditor has contractually secured from a debtor.

In *Till*, the Seventh Circuit has followed the coerced loan theory and arrived at the conclusion that a creditor's contract rate of interest, absent persuasive evidence otherwise, plus the replacement value of its collateral is presumptive of the "value, as of the effective date of the plan," of property to be

distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). *In re Till*, 301 F.3d 583, 592-93 (7th Cir. 2002).

The Sixth Circuit, in *In re Kidd*, 315 F.3d 671, 678 (6th Cir. 2003), has also recently adopted the "coerced loan theory." In determining the interest rate that the secured creditor should receive for making the coerced loan, however, the *Kidd* court concluded that the proper interest rate to be applied under § 1325(a)(5)(B)(ii) is "the current conventional market rate for similar loans in the region, and not necessarily the contract rate." *Kidd*, 315 F.3d at 678. In so doing, the Sixth Circuit introduced some sense of equality between like creditors and rejected a "market rate" dictated by a particular creditor.

B. The Results of the Confusion and the Coerced Loan Approach: Inequitable Treatment of Creditors and Undermining of Bankruptcy Policy.

The creditor based approaches of the various "coerced loan" theories, as noted by a leading Chapter 13 treatise, "are nightmares of logic and application." Keith M. Lundin, *Chapter 13 Bankruptcy*, 3rd Ed. 112-9(2002). In his treatise, Judge Lundin observes:

> Nothing in § 1325(a)(5)(B)(ii) suggests that "value, as of the effective date of the plan" is a creditor specific concept. If present value varies from creditor to creditor depending on facts specific to each creditor's financial condition,

> management and lending practices, then the interest rate at confirmation in a Chapter 13 case will be different with respect to every claim, with respect to every creditor, with respect to every day and all the relevant evidences proprietary to the holder of the secured claim. It is not imaginable that Congress intended "value, as of the effective date of the plan" to mean that inefficient, poorly managed lenders get higher interest rates than well managed, better capitalized lenders.

Id.

Contract rate or creditor specific rates effect a basic imbalance in the structure of a reorganization. Following creditor specific coerced loan rates and ignoring the congressional mandate that a claim only be paid its "present value" will lead to the anomalous determination that an efficient creditor with appropriate and accurate lending policies who is well capitalized with access to a broad market for funds will receive *less* in a Chapter 13 plan than an inefficient, sub-prime or predatory lender who, by receiving its higher contract rate of interest for its allowed secured claim, is being compensated for poor credit decisions and inefficient or ineffective operations. In essence, the efficient creditors would be subsidizing the inefficient sub-prime market predatory lenders. Indeed, no bankruptcy policy is served by establishing varying interest rates that Chapter 13 debtors have to pay based upon a creditor's efficiency, or lack thereof. *Smith*, 718 F.3d at 952.

The principles of equality are shattered by applying a creditor-unique contract interest rate to determine the present value factor added to the value of collateral in a Chapter 13

case. A simple example, often seen in Chapter 13 cases, is illustrative:

> A family has financed three identical automobiles and has proposed in a Chapter 13 plan to pay the creditors, with liens on the cars, the present value of the cars. Assume the replacement value of this type of automobile is $15,000. One is financed by a subprime lender, with a contractual interest rate of 23% per annum, one is financed by a conventional and efficient lender charging 7% per annum, and one is offered either at a "we tote the note" used car dealership (which does not include interest on its financing, making up for that source of income by establishing a significantly higher purchase price for the vehicle) or sold with a "zero percent financing" (a lower interest rate established for marketing on other purposes). If contract rate were to control, these three claims would be paid over 48 months at $480.77 per month, $359.19 per month, and $312.50 per month and the creditors would be paid $23,076.96, $17,241.12, and $15,000 respectively, even though each creditor has identical collateral of identical value, all subject to the same bankruptcy proceeding initiated by the same debtor.

Applying *Till* to the statutory scheme of the Bankruptcy Code, a secured creditor's inefficient lending practices would not simply be a cost born by the efficient secured creditors in a Chapter 13 case; but the unsecured creditors would have to pay for it as well. Under § 1325(b), a debtor is obligated to pay all disposable income to fund a Chapter 13 plan.

The debtor's disposable income paid to the trustee over the plan life creates a fixed pool of funds that the trustee can distribute to all creditors. As shown by the typical Chapter 13 case illustration above, to the extent an inefficient or sub-prime high interest rate lender is entitled to receive a greater claim than an efficient and careful creditor, the inefficient creditor receives a greater portion of the pool of funds. The general unsecured creditors will receive less of these funds and ultimately bear the cost of the inefficient creditor. Again, this result runs counter to bankruptcy policy, here, because it creates an inequity in the distribution available assets or income.

Applying *Till* to the case illustration also shows that cases involving the "tote the note" or "0% financing" seller whose contract is 0%, absent persuasive evidence to the contrary, would result in a Chapter 13 plan paying no interest to such a creditor. Clearly, under such a Chapter 13, this creditor is not getting the present value of its allowed secured claim because the money paid to the creditor over the plan life is not the same as if the full amount of the allowed secured claim were paid to that creditor today. HR 95-598, September 8, 1997 95th Congress 1st Session, 350 (1977). Oddly, under *Till*, the evidentiary presumption of the burden of proof shifts from the debtor to the creditor in this situation; i.e. if the contract rate is in excess of present value, the presumption favors the creditor and the burden is on the debtor to establish persuasive evidence to the contrary, on the other hand, if the contract rate is lower than present value, the burden is on the creditor to establish persuasive evidence to the contrary.

A secured creditor is entitled to receive the present value of its allowed claim and nothing more. The concepts of administrative overhead, profit, liquidity of the underlying

obligation, and the numerous other factors that cause contract interest rates to exceed a simple present value should be excluded from determining the amount that must be paid on a secured claim. Under § 1325(a)(5)(B)(ii), a creditor is entitled to its present value; a creditor is not entitled to its profit, overhead, or other factors such as may be extorted from sub-prime borrowers. The "coerced loan" theories grant secured creditors "value" in excess of the amount authorized by the Bankruptcy Code and undermine the policies underlying the Bankruptcy Code and, therefore, this Court should reject those theories, adopted by the Seventh Circuit in *Till*.

C. A "Formula Rate" Utilizing the U.S. Treasury Rate More Accurately Represents Present Value Than the "Coerced Loan" Approach.

A "formula rate" utilizing the U.S. Treasury Rate appears to have its judicial genesis in *In re Smith*, 178 B.R. 946 (Bankr. D.Vt. 1995). In *Smith*, the bankruptcy court determined that the Treasury Rate, without any premium or "kicker," which best matches the maturity of an over-secured creditor's claim, is an appropriate present value factor in a Chapter 12 case. *Id.* at 956. At the beginning of its discussion in *Smith*, the court explains that it is looking for an honest interest rate that will further the goals of the bankruptcy reorganization while giving the secured creditor the protection to which it is entitled; an interest rate which is not too high or too low but is "just right." *Smith*, 178 B.R. at 949. Ultimately reaching its conclusion, the court states that the Treasury Rate for an instrument of similar term, while slightly overcompensating the secured creditor, comes as close as one can get in an imperfect economic's world to an interest rate that is just right for purposes of determining

"value, as of the effective date of the plan" in a Chapter 12 case. *Id.* at 953. The Treasury Rate is the most appropriate rate as opposed to other rates because it includes some components of interest that comprise a discount rate, or present value, such as inflation and liquidity, but does not include the interest components to which a creditor is not entitled under the Bankruptcy Code such as profit, default, or risk premiums. *Id.* at 954-55. Additionally, the *Smith* court notes that the Treasury Rate even provides the secured creditor with a discount "kicker" because the Treasury Rate contemplates payments on a six month or annual basis whereas payments in a typical bankruptcy repayment plan are made monthly. *Id.* at 956.

In *In re Valenti*, 105 F.3d 55 (2nd Cir. 1997), the Second Circuit adopted a modified version of the *Smith* court's formula rate. In reviewing a decision from the District Court for the Northern District of New York, the *Valenti* Court ruled that the appropriate present value factor under § 1325(a)(5)(B)(ii) should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium from one to three percent to reflect the creditor's risk in receiving deferred payments. *Valenti*, 105 F.3d at 64. If the parties are not able to stipulate, or agree, as to this risk premium, then the bankruptcy court should conduct a hearing limited solely to a determination of that premium. *Id.* In reaching its decision, the Second Circuit, noted that full payment of an allowed secured claim under § 1325(a)(5)(B)(ii) *includes* a present value component. *Valenti*, 105 F.3d at 63. A creditor who receives present value is placed in the same position that it would have been in had it received the value of its collateral on the date that the Chapter 13 plan was confirmed. *Id.* The *Valenti* court also

observed that courts adopting the coerced loan approach had held that the appropriate interest rate should include the creditor's profit that would have been generated had the value of the collateral been received immediately. *Id*. The *Valenti* court, however, concluded that a creditor's allowed secured claim does not include any degree of profit on its discount rate. *Id*. at 64. If the creditor received the profit component of its contract interest rate, it would receive more than the present value of its allowed claim. *Id*.

The *Valenti* court actually found that the "cost of funds" approach (determining the applicable interest rate based upon the rate that the creditor itself pays to borrow funds) may more accurately represent present value than the Treasury, or formula, rate, and certainly more accurately than the "coerced loan" rate. *Id*. The court rejected this approach, however, because it is expensive and inefficient for bankruptcy courts to administer and because the creditor-specific based rate inequitably treats debtors depending upon how much their respective creditors have to pay to borrow funds. *Id*.

Subsequent to the Second Circuit's decision in *Valenti*, the Bankruptcy Court for the District of Vermont issued another decision on the issue in *In re Vessico,* 227 B.R. 352 (Bankr. D. Vt. 1998). In *Vessico*, the bankruptcy court questioned the *Valenti* court's imposition of a risk premium in addition to the Treasury Rate in light of this Court's subsequent decision in *Associates Commercial Corporation v. Rash*, 520 US 953 (1997). *Vessico*, 227 B.R. at 355. In *Rash*, this Court recognized that the risk of default is a factor to be encompassed in the determination of value under § 506. *See Associates Commercial Corporation v. Rash*,

520 US 953, 963 (1997). Accordingly, in light of this Court's decision in *Rash*, it may not appropriate to burden the "present value" factor with the entire risk of default.

Based upon the foregoing, a formula rate, consisting of the Treasury Rate for an instrument with a maturity equivalent to the repayment schedule under the debtor's plan plus a risk premium of one to three percentage points as determined by the parties through agreement or by the bankruptcy court as trier of fact, is the rate that best represents the "interest rate" or "present value" to compensate the secured creditor for the "value, as of the effective date of the plan" under § 1325(a)(5)(B)(ii). As much as possible, this rate puts the creditor in the same position as if it had obtained the full amount of its allowed secured claim as of the date of a Chapter 13 plan's confirmation by providing for the components of interest such as inflation, liquidity and risk. The formula treats similar creditors in a plan similarly. Furthermore, this formula rate does not compensate the secured creditor for those components of interest to which it is not entitled under the Bankruptcy Code such as profit, recovery of overhead and inefficient lending practices. The rate is simple and efficient to compute allowing the parties and bankruptcy courts to focus their limited resources on other issues such as plan feasibility and claim valuation. Ultimately, this formula rate advances the policies of the Bankruptcy Code by fulfilling the statutory requirements, paying the secured creditor the amount to which it is entitled, while, at the same time, allowing the debtor the opportunity to reorganize under a Chapter 13 plan whose feasibility is not jeopardized by requiring the debtor to pay excessive amounts of interest and treating creditors within the same class equally.

CONCLUSION

For the reasons set forth in this *Amicus Curiae* Brief, the NACTT supports the position of the Petitioners and respectfully requests that this Court reverse the Seventh Circuit's decision in *Till* that a creditor's contract rate of interest, absent persuasive evidence otherwise, together with the replacement value of the creditor's collateral, is presumptive of the value, as of the effective date of the plan, of property to be distributed under a Chapter 13 plan on account of the creditor's allowed secured claim as set forth in 11 U.S.C. § 1325(a)(5)(B)(ii). This Court should instead adopt a "formula approach" to determine present value; specifically, the present value component of an allowed secured claim should be fixed at the Treasury Rate for the comparable repayment schedule under the debtor's plan plus a premium of one to three percentage points to reflect the creditor's risk in receiving deferred payments. Utilizing the Treasury Rate fulfills the statutory requirements while advancing the policies of the Bankruptcy Code by paying a secured creditor that to which it is entitled and promoting fairness among creditors. In the event that this Court rejects a formula approach utilizing the Treasury Rate, this Court should consider establishing the present value component as "the current conventional market rate for similar loans in the region, and not necessarily the contract rate" which in the NACTT's position is not preferable to the formula approach but at least introduces some sense of equality between like creditors by rejecting a "market rate" dictated by a particular creditor.

Respectfully submitted,

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